C2710-2

© Entire contents copyright 1992 by Crain Communications Inc. All rights reserved

September 28, 1992

Pen Investments

The Newspaper of Corporate and Institutional Investing — $10 An Issue $150 A Year

#BXBLLBG********5-DIGIT 20814
TLZ
#040526692 5#01PI22026 99
STATISTICAL REF INDEX
4520 EAST-WEST HWY SU 800
BETHESDA MD 20814

AT DEADLINE

Massachusetts sues insurer

The Massachusetts attorney general filed suit Sept. 18 against Nationwide Life Insurance alleging the insurer breached its contract with the state by not complying with stipulations covering the fixed annuity option of the state's deferred compensation program.

The action comes after months of wrangling over the structure and management of the option, which contains about $677 million of the plan's total assets of $712 million.

Florida board hires Wells

The Florida State Board of Administration hired Wells Fargo Nikko to manage a passive international equity portfolio, said Ash Williams, executive director.

The account will be funded through cash flow and is limited to 5% of the $30 billion fund. There will be no currency hedging. SEI Capital Resources assisted.

Missouri refusing to divest

The Missouri State Employees' Retirement System will not move to divest South Africa-related stocks from the $2.2 billion pension fund, despite a Sept. 28 deadline set by the Legislature.

Said M. Steve Yoakum, executive director: "The board feels that to divest . . . would violate its fiduciary responsibility."

Legislators reportedly are considering bringing suit to force divestment.

Provision survives

An attempt to kill a provision exempting Federal Express'

Continued on page 46

INSIDE

LINDA SUE SCOTT

CEO pay explored

Graef Crystal's study of compensation levels for chief executive officers at 300 major corporations found 1991 pay ranged from zero to $63.6 million, with little correlation to company performance. Page 31.

RJR modernizes pension plans

New hybrid benefits all segments of the workforce

By Hillary Durgin

NEW YORK — RJR Nabisco Inc. is shelving its two defined benefit plans and adopting a new hybrid that boasts features of popular defined contribution plans.

RJR joins a growing list of companies acknowledging the need to update dinosaur-like defined benefit plans in response to today's increasingly diverse and mobile workforce. Some companies don't want to abandon these plans in favor of defined contribution plans if they can adapt the defined benefit plan to better meet the needs of employees.

RJR's plan, developed by The Wyatt Co., New York, retains the guaranteed benefit available under traditional defined benefit plans. It also promises employees easy-to-understand lump-sum benefits and portability, features that can make 401(k) and other defined contribution plans attractive to employees. But unlike defined benefit plans, which reward older, longtime workers, and defined contribution plans, which reward younger employees, the RJR plan will reward young, mid-career and longtime employees.

The new plan design makes the pension benefit "more an element of total compensation than just a future promise that you're not going to see for many years," said Gerald Angowitz, vice president, employee benefits at RJR Nabisco. "That reality is very pressing," he said.

"We want to be positioned properly to attract the right type of employees in both companies," Mr. Angowitz said, referring to RJR Nabisco's R.J. Reynolds Tobacco Co. and Nabisco Foods Group. The new plan addresses "the more diverse work force evolving in the 1990s and beyond."

RJR Nabisco's new plan, effective Jan. 1, replaces the tobacco company's $1.5 billion traditional defined benefit plan and Nabisco's $1 billion cash balance plan. The company's $1.2 billion 401(k) plan will not change.

RJR will switch by amending its existing plans. Had it terminated the defined benefit plans, it would have had to pay income and excise tax on any reversion.

The change will not increase RJR's pension expenses beyond administration costs associated with the conversion. The company also does not expect to alter its investment strategy.

The RJR Nabisco plan appears to be the latest variation in flexi-

See **RJR** *on page 42*

Bush pension would be 71% of pay

By Joel Chernoff

WASHINGTON — If President Bush is forced into retirement in January, he'll certainly be a lot better off financially than some of his predecessors.

Mr. Bush will get a presidential pension of $143,800 a year — 71.5% of his presidential pay. He'll also receive federal pension benefits to which he's entitled from his many years of public service, including as vice president, U.S. ambassador to the United Nations, director of the Central Intelligence Agency, a U.S. congressman and from his years in the Navy.

Former presidents Ronald Reagan, Jimmy Carter, Gerald Ford and Richard Nixon also receive the $143,800 annual pension, which is tied to the level of pay given cabinet officers.

Some of the earliest presidents, however, faced financial duress once they retired. Thomas Jefferson, for example, was forced to sell his prized library to Congress, and later applied to the Virginia Legislature to permit him to sell his treasured Monticello estate in a lottery to cover his debts.

James Madison had to sell half his property and often lived on borrowed funds, according to "Beyond the Presidency" a book by Marie Hecht. James Monroe also was forced to sell land and had to press Congress to repay him for expenses incurred on a mission to France.

After losing all his liquid assets in his son's bankrupt banking business, Ulysses S. Grant turned to writing his memoirs, while suffering from throat cancer. A generous contract from Mark Twain kept him solvent.

In 1912, Andrew Carnegie said he would provide annual pensions of $25,000 a year to all future presidents, as well as their widows until they remarried. But President William Howard Taft

See **Pensions** *on page 45*

AP/WIDE WORLD PHOTOS

If George Bush were to retire today, he'd get the same annual presidential pension — $143,800 — that Richard Nixon gets, even though he left office almost 20 years ago.

Managers avoid the currency bloodbath

By Joel Chernoff and Anne Schwimmer

International and foreign exchange managers escaped the turmoil in European currency markets relatively unscathed, switching out of weaker European currencies in advance of the near-collapse of the European Exchange Rate Mechanism.

If anything, some money managers moved too soon, bringing down their returns this summer. "We were too early on our global funds," said Mark Beale, director, WorldInvest Ltd., London.

Meanwhile, opportunistic treasurers at multinational corporations were locking in current exchange rates for the dollar vs. the European currencies once the dollar started picking up, in order to fund their European subsidiaries' cash needs.

The big losers, of course, were the European central banks, who bought tens of billions of British pounds, Italian lira, Spanish pesetas and French francs in often futile efforts to support these currencies.

Money managers claimed victory with their hedging programs, but the truth won't be known until September performance figures roll in. Pension executives generally said they had no knowledge of how their funds fared in the monetary upheaval.

Some investment management professionals argue the currency crisis will lead pension executives to pay greater attention to the need for currency overlay systems. "This is a wake-up call, the same way the October '87 crash was a wake-up call for stock market participants," said James McConnon, chief investment officer, RXR Capital Management, Stamford, Conn., a currency overlay manager. "A lot of people didn't know how much risk they had."

Others hope the turbulence will cause pension officials to view currencies from a policy perspective, instead of as just a risk-reduction and incremental value tool.

The market turmoil "underscores the need to have a well-thought-out currency strategy," said Lawrence Davanzo, managing director of Asset Strategy Consulting, Los Angeles.

But Gunter Ecklebe, director of international consulting at Frank Russell Co., Tacoma, Wash., doesn't expect to see strategic changes because of short-term fluctuations. Only six of Russell's 40 consulting clients now use currency overlay strategies.

ITT Corp.'s pension fund, with

See **Currency** *on page 43*

NEWS DIGEST

AP WIDE WORLD PHOTOS

The design and funding of pension plans for NFL players could be reshaped, all because a federal court decided the league's restrictive free agency system is improper. Page 47.

SPECIAL REPORT: DEFINED CONTRIBUTION PLANS

As employers wring their hands over a new law taxing early pension distributions, financial institutions are waving a multitude of products at employees. Page 17.

Caterpillar Inc. joins the small list of companies that have created their own mutual funds primarily to serve their defined contribution plan participants. Page 17.

More companies are shifting the cost of defined contribution plans onto employees, but participants are getting more for their money, a survey shows. Page 18.

CEO COMPENSATION

Money's motivational magic is vastly overrated in driving a CEO to improve corporate performance, but fear is underrated as a motivator. Page 31.

FINANCING

Investors are not bananas over Chiquita Brands International's exchange offer to shareholders. Page 3.

INTERNATIONAL

International and foreign exchange managers escape turmoil in European currency markets. Page 1.

In 'routine' governance matters, U.S. shareholders have more say abroad than they do at home. Page 23.

REAL ESTATE

The Alabama Retirement Systems leads a group to take over a major Manhattan office building. Page 2.

DEPARTMENTS

Classified	44	Hirings	40
Commentary	14	Opinion	12
Datebook	35	People	38
Frontlines	9	P&I Indexes	9

Vol. 20, No. 21 — Pensions & Investments (ISSN 1050-4974) is published biweekly with a special edition in May by Crain Communications, Inc., 740 Rush St., Chicago, Ill. 60611-2590. Second class postage paid at Chicago, Ill. and at additional mailing offices. Postmaster: Send address changes to Pensions & Investments, Circulation Dept. 965 E. Jefferson, Detroit, Mich. 48207.

Washington fund takes hit

Investment returns plummet following writedown

By Steve Hemmerick

The Washington State Investment Board's investment return took a serious dive because of a $470 million writedown the $16.5 billion pension fund took in June.

Daniel Grimm, state treasurer and board trustee, said the losses stem from the nation's bad economy and from poor control of some investments by previous fund executives and board members.

Mr. Grimm said the writedowns — 35% in leveraged real estate and smaller amounts in leveraged buy-out and venture capital investments — caused the fund's total return to drop to 8.2% for the year ended June 30, vs. 20% for the year ended Dec. 31.

That 8.2% return is about 500 basis points below the median return for pension funds of similar size, according to statistics provided by Washington fund officials.

Mr. Grimm said the biggest writedowns in values were for some of the pension fund's highly leveraged domestic real estate properties, formerly part of the U.S. portfolio of Canadian developer Cadillac Fairview Corp. The value of the fund's total real estate investment declined to $750 million from $1.2 billion. Its equity in Cadillac Fairview fell to $88 million from $450 million when purchased in 1987.

He said the board also has taken writedowns in value on investments in Red Lion Motor Inns, part of a buy-out led by Kohlberg, Kravis Roberts & Co., and, separately, a venture capital fund investment in a U.K.-based company.

He put some of the blame for the writedowns on the fact that some of the investments were carried at inflated values for at least two years.

In addition, Mr. Grimm said, former board trustees and administrators paid too much for some of the investments and signed contracts that gave the pension fund inadequate control over them, particularly over investment appraisals.

(John Hitchman, executive director from 1981 to 1988, declined to comment. Mr. Hitchman now is a portfolio manager for Hotchkis and Wiley, Los Angeles, one of Washington's equity managers.

(David Weig, now a consultant but who succeeded Mr. Hitchman as executive director, said: "I certainly refute any mismanagement charges." He acknowledged real estate is being written down in value now, but noted that's true for every pension fund that's taking a realistic look at its property holdings.)

Back in 1987, officials for the Washington board expressed optimism about future investment returns from the non-retail, Cadillac Fairview properties in the United States.

See **Hit** *on page 44*

Alabama moves on Manhattan

Fund leads takeover of O&Y skyscraper

By Barry B. Burr

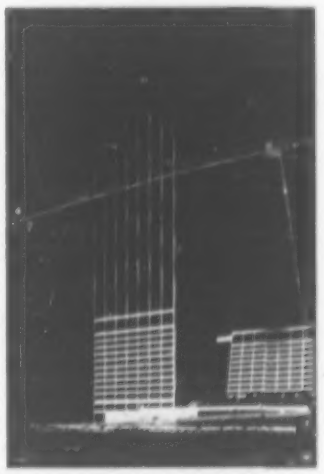
The Alabama Retirement Systems led a group of bondholders that agreed to take over from Olympia & York Development Ltd. the biggest office building in New York City.

The move, Alabama's first exposure to a major real estate market, was made to avert likely default on Olympia & York's mortgage debt next year by the financially beleaguered worldwide property company.

The 53-story building at 55 Water St. — one of the largest in the world with 3.64 million square feet — has a troubled outlook in the near term but promising long-term potential, according to advisers involved in the transaction.

A key reason for the positive outlook lies in the debt-free capital structure of the transaction and the willingness of enough of the would-be new equity owners — the former bondholders — to commit more equity capital. Unlike other workout deals, this one leaves 55 Water St.'s capital structure all equity with no contemplation of adding any mortgage debt, allowing the expected annual cash flow of about $20 million generated by rents to be plowed back into the building for badly needed improvements.

David Bronner, chief executive officer of the $12 billion Alabama fund, said none of the problems is insurmountable. Rather, he viewed the acquisition as "one of those Wall Street no-brainers."



The acquisition of 55 Water St. was a 'no-brainer,' according to Alabama's David Bronner.

"To me it was an opportunity," he said. The Alabama fund was the leader in arranging the terms of the deal.

Mr. Bronner in general believes the real estate market is beginning to improve, or at least that the worst is over. He said the fund is scouting for more real estate deals, although he isn't targeting a specific allocation.

"We're about in as good of a position as we could be, as we have no exposure to this marketplace," Mr. Bronner added. The Alabama fund had less than 1% in real estate before this transaction.

The building has immediate problems that need attention, according to Mr. Bronner and Stephen Glennon, principal, S.N. Phelps & Co., Greenwich, Conn., a boutique investment banking firm specializing in financial restructurings that advised the Alabama fund.

Despite an occupancy rate of 82%, a substantial number of the building's leases are scheduled to expire soon. Citicorp, in fact, has given notice and will leave by November, dropping the occupancy rate to 68%.

In addition, the building needs

See **Alabama** *on page 44*

Merger boosts Mellon's stature

By Terry Williams

PITTSBURGH — Mellon Bank Corp. is poised to join the elite in the master trust and custody business with its $1.45 billion purchase of The Boston Co. from Shearson Lehman Brothers Holdings Inc.

"We have been at the small end of the top tier," said W. Keith Smith, vice chairman of Mellon, describing the bank's master trust and custody operation. "By putting the two together, it will take us to $650 billion under administration.

"That is more than half the size of State Street," he said. "As a result, we will be more competitive."

Included in Mr. Smith's calculations are both banks' private client operations and the mutual fund administration business of Boston Co.'s Boston Safe Deposit & Trust Co. subsidiary.

According to a *Pensions & Investments* 1992 survey of master trust providers, both firms ranked in the top 10 in asset size. Mellon had $183.086 billion in master trust/custody assets administered, and Boston Safe Deposit had $190.725 billion.

The firms also ranked in the top 10 in terms of new business: Mellon took in $31.327 billion, while Boston Safe grabbed $5.23 billion in new business.

The intent is to merge the two trust and custody systems, said Mr. Smith, but combining the investment advisory operations is not "a realistic concept," said Mr. Smith.

"We (Mellon) have six investment management subsidiaries," said Mr. Smith. "Each one of

See **Mellon** *on page 45*

DENVER INVESTMENT ADVISORS
INCORPORATED

633 17TH STREET
SUITE 1800
P.O. BOX 17467
DENVER, CO 80217

Successful Fixed Income Management with a Focus on Corporate Bonds

For more information, please contact:
Dennis E. Larkin
Vice President
(303) 293-5588

Missouri fund shifts equities to passive

By Christine Philip

JEFFERSON CITY, Mo. — The $2.2 billion Missouri State Employees' Retirement System will terminate all five of its active equity managers Dec. 31 as part of a significant increase in the fund's passive portfolio.

The fund has $1.165 billion, or about 53% of the total portfolio, in equities. About $970 million, or roughly 80%, of the equity portfolio was actively managed. After the realignment, $740 million, or 62%, will be passively managed.

The fund's active equity managers — Alliance Capital Management L.P., CFW Management Co., Delaware Investment Advisers, Shields Asset Management Inc. and The Twentieth Century Cos. — have received notice, but M. Steve Yoakum, executive director, indicated they will be invited to take part in searches to complete the fund's restructuring.

General American Investors Co. Inc., which runs the existing passive equity account, was retained.

Of the equity portfolio, about $930 million, or 80%, will be in large-capitalization stocks: $560 million will be in an S&P 500 index fund; $180 million will be in large-cap value stocks (half active, half passive); and $180 million will be in large-cap growth stocks (half active, half passive).

About $200 million, or 17% of the equities, will be in actively managed small-cap stocks, split between growth and value.

The fund also has $35 million in venture capital, which had been considered part of the equity portfolio but now will be broken out, that will remain unchanged.

Loomis, Sayles & Co. Inc., Boston, which ran $136 million in intermediate-term bonds, also was terminated. A search is under way for an interest rate timer, said Mr. Yoakum.

All bond portfolios are actively managed, but Mr. Yoakum said passive management might be considered at a later date.

The portfolio "was so well diversified that it mirrored the market," said Mr. Yoakum, explaining the changes. "The board was looking to make the core of the portfolio passive equities, in order to at least match market performance through an index with cost savings in fees." ■

ON A 401(k) AS A BENEFIT

Ford: "It used to be the dental plan. Now it's the 401(k) plan."

Meet Gail Reilly of Lancer Insurance Company, R. Ford Hutchinson of Combe, Inc., Leonard Hirsh of Ernst & Young, and Lynda Sacharov of Richards & O'Neil.

What do veteran 401(k) sponsors say about the importance of a 401(k) plan as a key employee benefit? What can you learn from the issues they faced, the problems they solved, and the experiences they shared? Scudder recently held a "401(k) Roundtable" to discover some of the answers.

Do potential employees see a 401(k) plan as a benefit?

Gail: Benefits in general are a major subject these days.

Ford: It used to be the dental plan. Now it's the 401(k) plan. It's very important in the hiring equation.

"And they say... Thank you, company, for providing this."

How so—specifically?

Ford: If you don't have a 401(k) and you're after somebody you really want—and they're looking at other companies that do have a plan—you could lose that person. It might be just the thing that swings them. They say "Do you have a savings plan?" And that's what they mean...a tax-advantaged investment plan.

How important is your 401(k) with current employees?

Gail: It depends on your employee mix—the age factor of your employees . . .

Leonard: If you didn't belong to the plan, you would be putting money into an IRA—and you're limited to $2,000. Here you have a much better opportunity to put in $8,475 and possibly get a company match.

Does that help you hold on to key employees?

Ford: More than once, I've had employees say to me that the reason they're in our 401(k) isn't because the company contributes—and it isn't for the tax advantages. It's because we have provided them—through payroll deductions—a disciplined and convenient way to save. And they say, you know, "thank you". Thank you, company, for providing this.

What can an administrator do to help you reach that happy point?"

Leonard: Look at the kind of benefits statement an administrator would provide you, and how often it's provided. If it's quarterly, how soon after the quarter? How clear is that benefit statement going to be? Can you understand it? Can participants understand it?

Ford: There ought to be ways they can modify and tailor statements to your particular needs.

Lynda: When we had some difficulty understanding our statement, we went to our administrator and said, "What can you do for us?" They made some modifications and it was clearer. It was quite well done.

TO LEARN MORE...

This 401(k) Roundtable was sponsored by Scudder. The Scudder 401(k) program offers a family of no-load mutual funds (including noted international funds), a managed GIC fund, comprehensive participant accounting services (COMPASS), corporate trustee services, an IRS approved and tested prototype, and a reputation for personal client service. Scudder Investor Services, Inc., underwrites over 50 mutual fund portfolios.

SCUDDER

1-800-323-6105
Scudder Investor Services, Inc.
175 Federal Street
Boston, Massachusetts 02110

For free reprints of each advertisement in this series, please call or write Scudder.

CORRECTIONS & CLARIFICATIONS

• In the Aug. 17 report of **PIPER Managed Accounts**, the returns for Wilke/Thompson's small-cap growth equity fund was incorrect. The three-month return should have been −4.6% and the one-year return, 20.7%.

• The total taxable and tax-exempt assets of all managers ranked on page 16 of the Aug. 31 **Real Estate Managers Directory** was incorrect. The correct total is $281.105 billion.

• In a Sept. 14 story on **Aetna Life & Casualty Co.** and **Faneuil Securities Inc.**, it was incorrectly reported Aetna officials admitted they had a contract with Faneuil Hall Securities President Carmen Elio that paid him commissions for pension business he brought the insurer. Aetna admitted it failed to tell 19 Massachusetts municipal retirement systems that state Sen. William Q. MacLean's insurance company earned brokerage commissions on investments the systems made with Aetna, on Mr. Elio's recommendation. The insurer also admitted it did not disclose to the retirement systems that Mr. Elio worked as a municipal pension consultant to Mr. MacLean.

• An incorrect figure was reported in **The MLM Index** in the Sept. 14 issue. The 12-month return is 2.16%.

MONEY MANAGERS

Montgomery brings specialists under one umbrella

Mark Geist, president of Montgomery Asset Management, thinks the era of investment boutiques is over.

■ Executives at Montgomery Asset Management, San Francisco, are fashioning their firm into a house of boutiques, where it will be easier for the pension fund executive to shop for specialty money managers.

Mark B. Geist, president, said the firm's approach is the next stage in the evolution of money management, which began with big banks and then moved to individual boutiques. "The day of the small boutique is gone," he said.

Montgomery, which is less than 3 years old, has $750 million under management and three investment boutiques under its roof — small-cap growth, emerging markets and fixed income.

In each case, Montgomery Asset Management executives recruited practitioners in that style to come to work for Montgomery, giving them a small ownership interest in the company and a large stake in their own area.

Mr. Geist said Montgomery might add another international style, such as global or emerging markets fixed income; high value-added mid-cap or larger-cap growth stocks; and quantitatively based equity or fixed income.

— Nancy K. Webman

FINANCING

Global offerings post 75% gain

■ A record amount of capital was raised through global offerings of depository receipts in the first half of 1992, representing a 75% increase from 1991's first half record total, according to a report from the Bank of New York.

U.S. exchange-listed trading volume for the first six months equaled 2.3 billion depository receipts valued at $65.5 billion, an increase of 53% from 1991's mid-year high. The bank predicts trading volume for the full year will reach 8 billion depository receipts valued at $160 billion.

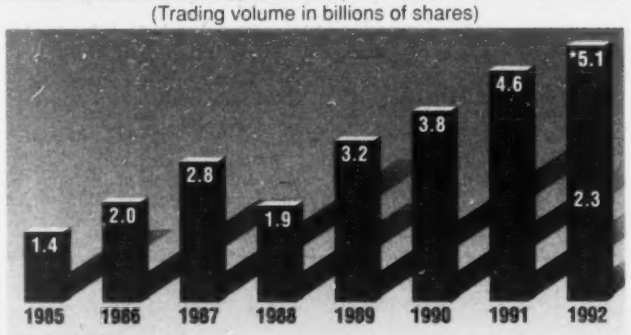
Reflecting the market's global diversity, 10 non-U.S. companies completed depository receipt public offerings totaling $2.8 billion and 18 companies privately placed $2.8 billion under Rule 144A. For the first time, companies from India, Taiwan and Brazil established programs to raise capital in the United States. Latin American issuers took advantage of U.S. investor interest, bringing 16 deals to the market.

SEAQ International, the London-based quotation system, continues to play an important role in the trading of depository receipts. About 500 million depository receipts valued at $15 billion traded through SEAQ International.

— Marlene Givant Star

Annual share volume of depository recipts listed on NYSE, AMEX and NASDAQ

(Trading volume in billions of shares)



* Year end projection
Data are for depository receipts listed on exchanges only, and include ordinary and preferred depository receipts. 144A depository receipts are excluded.
Source: Bank of New York

CHRIS ROY

INTERNATIONAL

Magten targets evolving nations' sovereign debt

■ Two funds investing in developing country sovereign debt are being marketed by Magten Asset Management Corp., New York.

The funds, which are expected to total $100 million, are a limited partnership for foundations, endowments and individuals, and a group trust for pension funds. The first closing is expected Oct. 31.

Since early 1991, the firm has invested in the debt of such countries as Peru, Brazil, the Ivory Coast, Nigeria, Poland and, most recently, Algeria.

"We believe the securities available in this area should provide a 15% annual rate of return over the next several years. As the U.S. high-yield market has become pricier, these securities represent more and more compelling value. All of our clients and friends should seriously consider putting major amounts of money into these investments," said a report to clients.

While there is clearly economic risk, all of the investments are dollar-denominated so there's no currency risk. Debt will include Brady bonds and so-called "pre-Brady" bonds of countries expected to adopt a Brady plan. Brady bonds are securities issued in a negotiated restructuring of a developing country's commercial bank debt under a plan devised by U.S. Treasury Secretary Nicholas Brady.

"There's an opportunity for high returns and participation in a socially responsible investment vehicle. You're helping countries restructure their debt," said Barbara Justiz, managing director.

Magten initially will market the funds to its base of existing clients because 11% of their Magten portfolios already are allocated to sovereign debt.

— Marlene Givant Star

REAL ESTATE

Offices, apartments biggest problems

■ Last year, $8.2 billion in apartment loans — 5.6% of all apartment loans — were restructured, according to a study by Coopers & Lybrand, New York.

That percentage is second only to the office sector, where 6% of loans were restructured in 1991, according to the study. Yet, office properties generally are perceived to be in greater financial difficulty than apartment properties. (In a restructured loan, the lender and borrower often work out an agreement to avoid foreclosure.)

The Coopers & Lybrand study said loan restructurings are expected to continue for the foreseeable future because of the lack of liquidity in the real estate market, the gap between the expectations of buyers and sellers, and the continued pressures on the lending community, which already has a high amount of foreclosed real estate.

In 1991, lenders had $145 billion in apartment loans, $8.2 billion of which were restructured. Another $10.3 billion in loans were delinquent and $5.3 billion were in foreclosure. In 1990, only $2.1 billion in apartment loans were in foreclosure, according to the study.

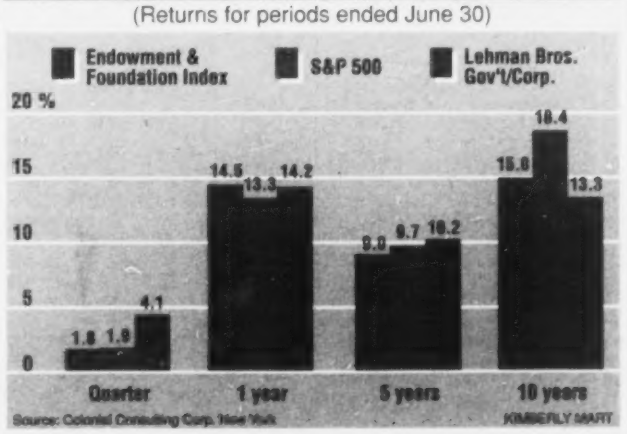
Of the $415 billion in office loans in 1991, some $25.8 billion were restructured, $29.2 billion were delinquent, and $14.5 billion were in foreclosure. In 1990, $9.6 billion in office loans were in foreclosure.

"This research for the first time puts hard numbers against the widely held industry view that loan restructuring is the most attractive option available to deal with delinquent loans given the economic climate and the state of the real estate market," said Bjorn Hanson, head of Coopers & Lybrand's National Real Estate Group.

— Steve Hemmerick

Endowment & Foundation Index

(Returns for periods ended June 30)



Source: Colonial Consulting Corp, New York

KRISTEL Y MART

ECONOMY

Biggs sees boon from Clinton win

■ Supposing Gov. William Clinton wins the presidential election in November, Barton M. Biggs, director-global strategy, research and economics for Morgan Stanley & Co., New York, suggests "confidence in the U.S., its economy, and its smart young president could be soaring" by the middle of next year.

Under the scenario, Mr. Biggs, in Morgan Stanley's Perspectives publication for clients, guesses the U.S. stock market will be up 10% to 20% by mid-1993.

"By midyear there will be talk that the U.S. economy is leading the world out of recession."

In his sanguine scenario, Mr. Biggs presupposes several key actions by a Clinton administration.

"I think (Mr. Clinton) will propose and Congress will enact a big cut in or an elimination of the capital gains tax, or at the very least, the retroactive indexing of capital gains for inflation," Mr. Biggs comments, noting the Democratic platform mentions a capital gains tax cut for "patient" investors. To ensure the benefits go to long-term investors rather than speculators, he believes the measure will require a holding period or three to four years to realize the favorable capital gains tax treatment.

But Mr. Biggs thinks Mr. Clinton will raise tax rates to perhaps 40% on incomes of more than $250,000 and to 50% for those more than $500,000 as a sop to populist critics of corporate executives' "obscene" compensation.

— Barry B. Burr

WASHINGTON

Court removes plan trustees

■ The Department of Labor succeeded in getting a U.S. district court to oust the trustees of the Houston-based Parker Brothers and Co. pension plan.

The court will appoint an independent trustee pending a final decision in the case.

The trustees are charged with losing up to $8 million of the $10 million plan through violations of the 1974 Employee Retirement Income Security Act, including:

- denying more than $3.7 million in lump-sum benefits to more than 200 terminated employees;
- investing $7.1 million in highly speculative and illiquid loans secured by raw land in the Houston area, in violation of ERISA's diversification and prudence rules;
- making loans from the plan that benefited themselves, including financing the sale of undesirable land owned by the concrete pipe and construction firm and a second loan that benefited the employer because the borrowers purchased materials from the company with the loan proceeds;
- transferring $383,000 in plan assets to Parker Brothers to meet the company's financial obligations; and
- failing to value plan assets annually at their fair market value, resulting in excessive benefits payments.

— Joel Chernoff

Rollover law boosts employer woes

By Hillary Durgin

As employers wring their hands over complying with a new law taxing early pension distributions, financial institutions are waving a multitude of products at employees, warning them against letting any assets slip through their fingers.

The law, which goes into effect in January, would levy a 20% tax on all pension distributions that employees receive when they retire or change jobs. The only way to avoid the tax is by rolling over the assets directly into a new qualified plan, such as an individual retirement account, within 60 days.

While the law simplifies and expands old rules by permitting most plan distributions to be rolled over, it entails compliance headaches for employers.

Designed in part to encourage rollovers by the 89% of workers who don't transfer their distributions directly into a new plan, the law could have important implications for employees' retirement savings. In addition, there is a large pool of assets — $48 billion was distributed, but not rolled over, in 1988 alone — the government can tax or financial institutions can manage in IRAs.

"(The law) clearly will increase rollovers and probably quite dramatically," said Dallas L. Salisbury, president, Employee Benefit Research Institute, Washington. "Part of that is what this provision will encourage in the way of changes in the qualified plan business."

Mutual fund providers like Fidelity Investments, The Vanguard Group and The Putnam Cos. are reaching out to 401(k) clients and individuals, offering them painless ways to transfer their money. Bankers Trust Co. also plans to market a rollover IRA vehicle.

Fidelity is talking to clients about offering a group IRA that could eliminate much of the administrative burden associated with the new rollover rules, said Eric P. Lofgren, consultant with The Wyatt Co., New York. A company could offer the group IRA option to all of its outgoing participants, dramatically decreasing the work load associated with arranging for transfers to multiple IRA providers or to new employers, many of whom will not want to accept transfers to their plans. Other service providers are expected to follow Fidelity's lead.

Right now, many plan sponsors are trying to get administrative and communications systems in place by early October to handle the new rules. Yet important technical questions abound. They range from whether companies with voice-response communications systems must send out written notices explaining the law to employees to how the transfers physically should be handled.

In early October, the Treasury Department is expected to issue guidance to employers that would answer questions on administrative issues and notice to employees.

In addition, legislation correcting some problems has been incorporated in the Senate version of a tax bill pending before Congress.

"There's a fair amount of start-up time" required to implement the new rules, said Howard Golden, partner with Kwasha Lipton, Fort Lee, N.J. "Companies are clamoring for guidance."

In the meantime, while employers recognize the merits of the law, they don't relish the added burden. Required administrative changes include modifying computer systems, redesigning communications forms and establishing procedures to complete the transfer of assets between plans.

"I do see it as a burden," said Marietta Booth, manager, defined contribution plans, Land O'Lakes Inc., Arden Hills, Minn. "We try to make things simple when people leave the company. It's not going to be simple anymore."

Ms. Booth would like to send letters to employees explaining the new law by Oct. 1. Beyond changing plan documents and the company's in-house systems, the company's primary effort will be spent explaining the new law to employees. "The cost is going to be time," Ms. Booth said.

Under the law, if employees don't have distributions transferred directly from their current plan to a new one, they risk having to pay the 20% tax.

Whether people transfer their distributions to a new plan depends to a large extent on employers' communications efforts, Kwasha Lipton's Mr. Golden said.

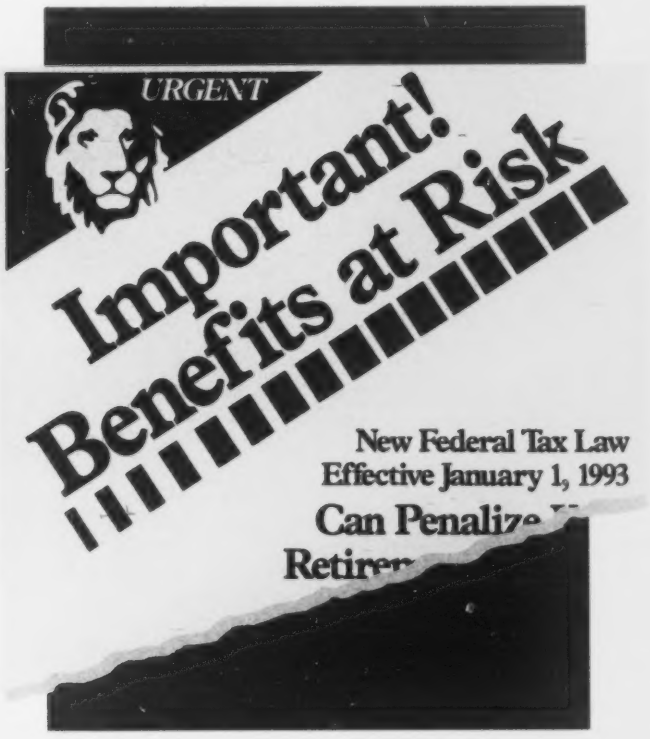
"The people who are going to be hit with the 20% are the people who are the least informed," Mr. Golden said. "It depends on the commitment and the ability of employers to explain these rules."

Some question whether employees truly will be deterred from taking the cash and spending it.

"I'm suspect of the portability enhancement," said Henry Saveth, principal, A. Foster Higgins & Co. Inc., New York. "As a practical matter, people who want the cash will take the cash. I don't think it will result in that many rollovers."

But executives at financial services firms say otherwise. Several are involved in aggressive marketing efforts encouraging individuals to avoid the new with-

See **Law** *on page 19*



Jay Mehta says Oki America has stressed communication in its education efforts.

Education paying off for workers

By Hillary Durgin

HACKENSACK, N.J. — Oki America Inc. is giving its employees a valuable lesson in saving for retirement. In fact, the company's paying them to learn.

To teach its employees how tax-deferred savings and compounding can build big account balances, Oki America automatically makes a contribution of 2% of every employee's salary to the company 401(k) plan every year after one year of service. On top of that, the company gives workers 50 cents for every dollar they contribute, up to 6% of their salary.

Oki America's automatic 2% contribution stands out because while many companies match a certain portion of their employees' contributions to their 401(k) plans, most don't make an up-front contribution.

Oki America's $12 million 401(k) plan is the company's only retirement plan.

Employees vest immediately in the 2% up-front contribution the company makes. They vest in the matching contribution after three years.

As a result of Oki America's strategy, employees receive a risk-free start to investing for retirement, and the company guarantees all of its employees participate in the plan, easing its ability to pass pesky non-discrimination tests.

Passing the tests, which ensure plans do not favor the highly paid, is necessary for a plan to maintain its tax-qualified status.

"The key thing I found, from the company's point of view, is it helps us to have the qualification issues resolved, the non-discrimination tests, and it's a very true and tangible benefit from day one," said Jay Mehta, senior director of finance. Oki America is a wholly owned subsidiary of Oki Electric Industry Co. Ltd., a Tokyo-based electronics company that makes computer printers, car telephones and silicon chips.

Generally, the tests ensure plans do not discriminate in favor of highly paid workers in terms of coverage and participation in the plan and contributions made on their behalf.

Because of the tests' complex nature and costs, many employers want Congress to pass new rules that would relieve them of the

See **Lesson** *on page 22*

Caterpillar expands mutual fund business

By Curtis Vosti

PEORIA, Ill. — It was almost three years in the coming, but Caterpillar Inc. has joined the small list of companies that have created their own mutual funds primarily to serve their defined contribution plan participants.

In doing so, Caterpillar enhanced its 401(k) plan so it now has nine options for participants, seven from its Preferred Group of Mutual Funds. The funds have an initial $320 million, about half each from company insurance and 401(K) accounts.

"We pretty much did it to service ourselves," said Michael Pond, president of Caterpillar Investment Management Ltd., the wholly owned investment subsidiary. "This is a big step. It's not the tractor business."

Other companies — including General Electric Co., AMR Corp. Bechtel Power Corp., Owens-Illinois Inc., IBM Corp. and the National Rural Electric Cooperative Association — also have created their own mutual funds, and the success of those can be hinted at through their approximately $11.5 billion in combined assets under management.

There are impediments, however. Bell Atlantic Corp., for instance, found start-up costs became prohibitive and sold its mutual fund accounts to T. Rowe Price Associates a scant two years after they were started.

"We never started it up with the idea that it would be a profit center," said Paul Currie, former director of the mutual funds and now director of investor relations. Mr. Currie said the funds — which were never offered to Bell Atlantic's savings plan participants but depended on the personal assets of the company's retirees and employees — drew $38 million before they were sold. Though the funds had steady growth during the first 18 months, future growth wasn't expected to be sufficient to meet the transfer agent, custodial, legal, audit, system and other overhead costs, he said.

"To get to a break-even point, we would have needed considerably more assets," Mr. Currie said.

Getting sufficient assets under management — what Ronald Boller at Owens-Illinois calls "a critical mass" — was Mr. Boller's primary concern when he began the company's mutual funds in 1986. By that time, Harbor Capital Advisors, the Owens-Illinois investment management subsidiary, was three years old. Mr. Boller thinks the fact the firm was already established before offering the mutual funds was essential to the success of the now seven funds Harbor offers, which have a total of $1.1 billion.

"You've got to find that critical mass somewhere," he said. "With the three years, we had time to study the economics of running an investment management company." The studies apparently paid off: from a modest beginning of just one fund with only a portion of its pension fund as a client, Harbor Capital draws 70% of its assets from outside the company, including both individual and institutional investors.

"We're not going to be a major player, that's not our mission," Mr. Boller said. "But it help us do our job better."

See **Funds** *on page 21*

Mutual fund operations

(As of June 30)

Manager	Number of funds	Total assets ($ millions)
General Electric Investment Co.	8	$6,400
AMR Investment Services Inc.	6	2,390
Harbor Capital Advisors Inc.	7	1,170
IBM Credit Corp.	4	1,010
Caterpillar Investment Management Ltd.	7	320
Fremont Investment Advisors Inc.*	3	161
Rural Electric Advisers Corp.	3	45

* A fourth fund was recently added.
Source: Lipper Analytical Securities Corp. and IBM Credit Corp.

A.TRANCHITA

Changing with the times

Company overhauls 401(k) to meet demands of '90s

By Hillary Durgin

DALLAS — In its heyday in 1982, Lone Star Steel Co., which had a town christened after its signature steel mill, employed 7,400 workers who pumped out more than $1 billion in annual sales.

Today, the company is a shadow of its former self. Desiccation of the oil and gas drilling industry forced Lone Star into bankruptcy in 1989. Now, its work force has shrunk to 1,350 and last year sales totaled $319 million.

As the company has struggled to right itself — it emerged from bankruptcy reorganization in mid-1991 — its employees are seeing a dramatic and welcome change in the $18 million 401(k) plan at Lone Star Technologies Inc., the management and holding company for Lone Star Steel.

Within two months of emerging from bankruptcy, the company launched an effort to overhaul the investment management and administration of its plan. The result is an annual saving of $40,000 for the company and greater flexibility for employees.

"We've taken away and taken away from our employees," said Curtis Crane, director of finances and taxes at Lone Star, commenting on the company's past 10 years. With the changes to the 401(k) plan, the company saves money, but the move is "perceived by our employees as 'Hey, they're really doing something for us.' "

As a result of the plan changes and an extensive employee communication and education effort led by The Putnam Cos., Boston, participation in the plan has jumped to 92% of eligible employees from 78% in less than a year.

Lone Star recently hired Putnam as a full-service defined contribution plan provider.

The 401(k) plan, which covers 600 salaried workers, previously offered employees five investment options and the opportunity to move assets between funds only twice a year.

The company had done little to educate its employees about saving for retirement, or about the risk and reward of various asset classes.

"One of the goals (of the new education effort) at Lone Star was to get participants to take a longer view," said Phil Lussier, managing director, national sales manager for Putnam's Defined Contribution Plan Services.

Before Lone Star overhauled its plan, employees could either invest all of their money in one option or split it between two options.

Guaranteed investment contracts drew all the money of 60% of the employees. The plan's balanced fund drew all the assets of 5% of the employees, followed by equities, the only investment for 3% of employees, and bonds, the sole option for 1% of covered workers. An insignificant amount of employees invested in company stock.

Only about 15% of all employees opted to invest their money in two as opposed to one fund. The remainder did not participate.

Now, 38% of the assets are invested in a growth and income fund, 34% are invested in a balanced fund, and 12% are invested in U.S. government bonds. Only 10% of the assets remain invested in GICs, while 5% are invested in a money market fund, and 1% is invested in company stock.

"We needed to offer our employees more of an opportunity to diversify their assets," Mr. Crane said.

So Lone Star called upon seven or eight mutual fund families. As it examined what different providers offered, the company found some of the mutual fund groups wanted the company to adopt their model plans. But Putnam was more flexible, Mr. Crane said. "Putnam came in and said, 'We'll work with you on your plan document,' " he explained.

Lone Star hired Putnam to provide bundled investment management, trustee and recordkeeping services. Putnam replaced The Wyatt Co., New York, as recordkeeper and The Vanguard Group, Valley Forge, Pa. and Texas Commerce Investment Management Co., Houston, as investment managers.

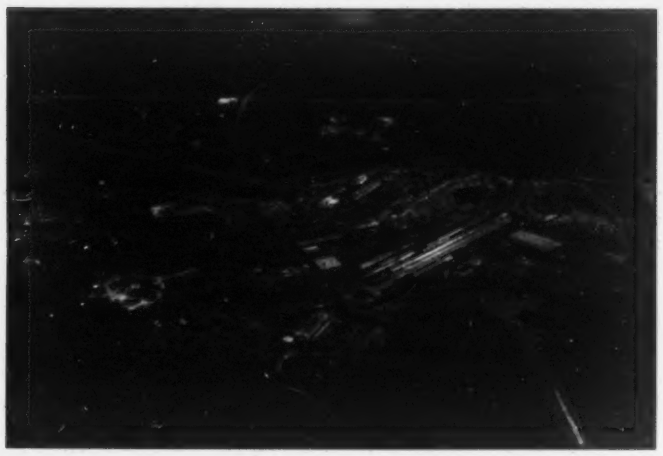
One of the most striking changes is the savings to the company. "From paying $60,000 to $62,000 a year in expenses, we've cut that down to roughly $22,000," Mr. Crane said. "The savings really broke down between recordkeeping fees and trustee fees."

"The best thing about Putnam is they came in, they gave enrollment classes," Mr. Crane said. "Everyone offers excellent funds, but the communication to the employees was the most vital in my opinion. That's on what basis you have to sell."

Changes also were made to the plan's design. Previously employees could only move money between investment options on a semi-annual basis.

"That's not user-friendly from a participant's point of view," Mr. Lussier said. Now employees can move money daily. "They took a giant leap to go from semi-annual to daily" transfers," Mr. Lussier said.

Other improved plan features include employees' ability to receive distributions within a week of leaving the company, as opposed to "a couple of months," Mr. Crane said. And loans now can be obtained within two weeks instead of six. ■



The overhauled 401(k) plan of Lone Star Steel has more diversification options and a participation rate of more than 90%.

Funds

Continued from page 17

Trying to do a better job led David Redo, president and chief executive officer of Fremont Investment Advisers Inc., to create mutual funds for its parent, Bechtel, in late 1988.

"Our first objective was to allow retirees and those leaving Bechtel to rollover their retirement fund money," he said. "Also, we received pressure from others in the company who wanted to be able to invest taxable assets. Mutual funds are the only vehicle that can do both."

Originally, Fremont offered two funds — a global, multiasset approach and a money market fund. In 1990, it added a tax-free California intermediate bond fund for its taxable investors.

"We learned a big lesson. These are expensive to run," Mr. Redo said.

To spread the costs across a wider spectrum, the funds were offered to outside investors in 1991 and a fledgling marketing effort, including videos, was launched. An equity fund was added in 1992 and an intermediate corporate bond fund is expected to be added in 1993.

Today, the Fremont funds have $200 million under management, about 40% from outside investors, with $48 million from outside institutional investors, he said. Fremont still doesn't invest any of Bechtel's pension assets, but does allow rollovers from plan participants.

Caterpillar began moving toward mutual funds in 1990, when it offered a group trust with seven investment options for the pension funds of its thousands of full-time dealers and suppliers. Although the group trust worked much like a mutual fund, Mr. Pond said in a 1990 interview, he didn't think then that Cat's investment management arm was ready to take the plunge.

This summer, however, he decided the staff had the experience to set up the service systems necessary to offer the mutual funds. Daily transactions, toll-free telephone access and more frequent benefit statements are part of the benefits, he said. The funds, however, will not be actively marketed outside the firm for now. ■

Putnam

401(k)

SERVICES

As

UNIQUE

AS THE

needs that

INSPIRE

them.

AT PUTNAM, *experience* over time has taught us that *no* two firms are alike and *no* two 401(k) PLANS are alike. As a result, we are DEDICATED to providing CREATIVE solutions to EACH of our clients' *individual* needs. To support our clients in delivering HIGH QUALITY 401(k) PLANS, we offer a *range* of CUSTOMIZED services including STATE-OF-THE-ART record keeping and administration, *superior* investment OPTIONS as *well* as OUTSTANDING employee and sponsor communications. We have created this program because we *understand* that a 401(k) PLAN is *only* as effective as the QUALITY of the SERVICES it *delivers*.

PUTNAM DEFINED CONTRIBUTION PLAN SERVICES. *Uniquely* designed. And *uniquely* RESPONSIVE to *your* needs.

Putnam

A TIME-HONORED TRADITION IN MONEY MANAGEMENT

The Putnam Companies
One Post Office Square, Boston MA 02109.

CEO COMPENSATION

Most highly paid CEOs

(Total current compensation)

Company	CEO	Size IQ	Performance IQ	Actual TCC ($ thousands)
Morgan Stanley Group	Richard B. Fisher	93	110	2,640
Time Warner	Steven J. Ross & N.J. Nicholas	115	79	6,960
Merrill Lynch	William A. Schreyer	110	93	10,350
Toys"R"Us	Charles P. Lazarus	104	112	5,530
Walt Disney	Michael D. Eisner	93	98	5,440
Bear Stearns	Alan C. Greenberg	84	102	5,300
Bell Atlantic Corporation	Raymond W. Smith	98	92	3,130
ConAgra	Charles M. Harper	113	120	4,000
Exxon	Lawrence G. Rawl	106	107	3,340
Colgate-Palmolive	Reuben Mark	99	107	3,310

Most lowly paid CEOs

Company	CEO	Size IQ	Performance IQ	Actual TCC ($ thousands)
Sears	Edward A. Brennan	88	102	1,000
Berkshire-Hathaway	Warren Buffett	101	120	100
Chrysler	Gerald C. Meyers	92	98	790
Price	Robert E. Price	94	100	270
Motorola	William J. Weisz Jr.	93	93	270
Amerada Hess	Leon Hess	100	87	300
General Motors	Roger B. Smith	105	98	340
Newmont Gold	Gordon R. Parker	68	97	410
Coca-Cola	Roberto C. Goizueta	125	123	10,640

Highest performing CEOs

(Ranked by performance IQ during CEO's tenure)

Company	CEO	Performance IQ during tenure	Overall performance IQ	Size IQ	TCC ($ thousands)	TDC ($ thousands)
Amgen	Gordon M. Binder	179	150	84	530	530
St. Jude Medical	Lawrence A. Lehmkuhl	169	150	52	570	1,080
The Gap	Donald G. Fisher	168	150	87	2,280	2,330
Costco Wholesale	James D. Sinegal	152	144	89	420	1,100
The Limited	Leslie H. Wexner	152	135	104	1,820	1,820
Dillard Department Stores	William T. Dillard	149	141	98	1,780	3,020
Novell	Daniel D. Ferguson	147	140	78	1,080	1,080
General Dynamics	William A. Anders	132	93	105	1,500	13,530
UST	Louis R. Barbe	130	132	70	2,440	3,530
Merck	P. Roy Vagelos	130	129	106	3,340	4,820

Lowest performing CEOs

Company	CEO	Performance IQ during tenure	Overall performance IQ	Size IQ	TCC ($ thousands)	TDC ($ thousands)
Tandy Corp.	John V. Roach	64	83	99	1,450	1,470
Federal Express	Frederick W. Smith	70	68	107	660	660
Burlington Northern	Gerald Grinstein	70	70	92	1,187	2,310
Digital Equipment	Kenneth H. Olsen	71	68	116	1,000	2,230
IBM	John F. Akers	72	72	110	2,160	4,330
Citicorp	John S. Reed	73	69	127	1,220	1,910
Halliburton	Thomas H. Cruikshank	74	74	105	1,200	1,500
Champion International	Andrew C. Sigler	74	73	103	1,140	1,760
Travelers	Edward H. Budd	75	71	108	900	2,270
Westinghouse	Paul E. Lego	75	79	118	680	3,250

CEOs with largest percent increase in TDC

(1991 vs. 1990)

Company	CEO	Final performance IQ	Performance IQ during tenure	1990 TDC ($ thousands)	1991 TDC ($ thousands)	% increase
Quaker Oats	William D. Smithburg	107	111	1,500	10,240	583
Coca-Cola	Roberto C. Goizueta	125	123	10,640	63,550	497
International Flavors & Fragrances	Eugene P. Grisanti	104	101	1,570	9,240	488
Cooper Industries	Robert Cizik	96	88	1,340	5,820	334
W.R. Grace	J. Peter Grace	90	87	2,500	10,250	310
Burlington Resources	T.H. O'Leary	94	94	1,770	6,510	268
Medco Containment	Martin J. Wygod	113	100	1,130	4,150	267
PPL Group	James L. Rossiter	93	93	1,180	4,200	262
McCaw Cellular	Craig O. McCaw	99	100	2,320	7,560	226
Field Union	Edward E. Crutchfield Jr.	92	90	970	2,640	703

CEOs with largest percent decrease in TDC

Company	CEO	Final performance IQ	Performance IQ during tenure	1990 TDC ($ thousands)	1991 TDC ($ thousands)	% decrease
Reebok	Paul B. Fireman	111	107	31,300	2,320	92
Time Warner	Steven J. Ross & N.J. Nicholas	79	79	99,620	11,000	89
Browning-Ferris	William D. Ruckelshaus	80	80	4,210	810	81
Federal Express	Frederick W. Smith	70	70	3,330	960	72
Chrysler	Lee A. Iacocca	93	107	4,500	1,480	67
Sara Lee	John H. Bryan	109	121	6,430	2,280	65
PepsiCo	D. Wayne Calloway	116	115	5,400	1,960	64
Emerson Electric	C.F. Knight	97	93	5,110	1,820	64
Phillips Petroleum	C.J. Silas	98	100	5,160	2,420	53
American Express	James D. Robinson III	87	85	4,300	2,240	52

Most highly paid CEOs

(Total direct compensation)

Company	CEO	Size	Performance	Actual TDC ($ thousands)
Coca-Cola	Roberto C. Goizueta	125	123	63,550
United States Surgical	Leon C. Hirsch	74	147	42,730
General Dynamics	William A. Anders	105	93	13,530
Time Warner	Steven J. Ross & N.J. Nicholas	115	79	11,000
Merrill Lynch	William A. Schreyer	110	93	10,350
Quaker Oats	William D. Smithburg	95	107	10,240
International Flavors & Fragrances	Eugene P. Grisanti	104	101	9,240

Most lowly paid CEOs

Company	CEO	Size IQ	Performance IQ	Actual TDC ($ thousands)
Berkshire-Hathaway	Warren Buffett	101	120	100
Price	Robert E. Price	94	100	270
Telecommunications	John C. Malone	105	104	450
Long Island Lighting	William J. Catacosinos	93	91	460

CEOs with most sensitive pay packages

(Upside scenario)

Company	CEO	Estimated gain ($ millions)
Microsoft	William H. Gates III	2,413
The Gap	Donald G. Fisher	1,846
Loews	Laurence A. & Preston R. Tisch	1,578
Novell	Raymond J. Noorda	427
Nordstrom	John A. Nordstrom, et. al.	425

(Downside scenario)

Company	CEO	Estimated loss ($ millions)
Microsoft	William H. Gates III	1,461
The Gap	Donald G. Fisher	1,131
Loews	Laurence A. & Preston R. Tisch	963
Nordstrom	John A. Nordstrom, et. al.	260
Dole Food	David H. Murdock	246

Most relatively overpaid CEOs

(Ranked by percent deviation)

Company	CEO	Actual TCC ($ thousands)	Actual TDC ($ thousands)	Size IQ	Competitive TDC ($ thousands)	Performance IQ	Final TDC ($ thousands)	% deviation
Time Warner	Steven J. Ross	6,960	11,000	115	2,570	79	1,260	773
UAL	Steven M. Wolf	580	17,200	108	2,260	98	2,230	671
W.R. Grace	J. Peter Grace	1,710	10,250	104	2,090	90	1,560	557
Masco	Richard A. Manoogian	1,500	6,550	98	1,870	83	1,070	512
United States Surgical	Leon C. Hirsch	2,070	42,730	74	1,420	147	8,120	426
International Flavors & Fragrances	Eugene P. Grisanti	1,570	9,240	104	1,810	101	1,810	410

Most relatively underpaid CEOs

Company	CEO	Actual TCC ($ thousands)	Actual TDC ($ thousands)	Size IQ	Competitive TDC ($ thousands)	Performance IQ	Final TDC ($ thousands)	% deviation
Berkshire-Hathaway	Warren Buffett	100	100	101	1,950	120	4,580	-98
Costco Wholesale	James D. Sinegal	420	1,100	89	1,700	144	8,890	-88
Wal-Mart	David D. Glass	920	1,220	129	3,190	126	9,270	-87
Nike	Philip H. Knight	650	650	85	1,630	123	4,250	-85
Reebok	Paul B. Fireman	2,320	2,320	111	2,320	107	31,300	-92

Source: The Crystal 300 CEO Report

GRAPHICS BY CHRIS ROY

Fear: The great motivator

Companies perform best when CEOs have a lot at stake

Graef Crystal, executive compensation authority and adjunct professor at the Haas School of Business, University of California, Berkeley, conducted the 1991 chief executive officer compensation study for Pensions & Investments in conjunction with his publication, The Crystal Report, based in Napa, Calif.

By Graef Crystal

Money's motivational magic is vastly overrated in driving a chief executive officer to improve corporate performance, according to the findings of a study of the pay of the CEOs of 300 major corporations.

But fear is underrated as a motivator. Executives who own lots of stock in their companies perform better than those who don't, the study found. To be sure, they are well remunerated if their company does well; but more importantly they stand to take a bath if their company fails.

The study of the 1991 compensation of the chief executive officers in terms of their stock market capitalization found little relationship in aggregate between CEO pay and corporate performance as measured by total return to shareholders.

Chief executive officers in the study received a wide range of pay for the year. Of the extremes, Novell Inc. got its chief executive officer — Raymond J. Noorda — to work for nothing, while Coca-Cola Co. paid its top executive — Roberto C. Goizueta — $63.6 million.

A full copy of the 56-page Crystal 300 report may be obtained by subscribing to The Crystal Report, 564 Montecito Blvd., Napa, Calif. 94559; (707) 226-8417.

Company performance accounted for less than 5% in the variation of "total direct compensation," a comprehensive measure of pay that includes salary as well as stock options.

Likewise, company size, a potentially key determinant in compensation, explained little of the variation in chief executive pay levels.

The best performing company during the chief executive officer's tenure, ranked by relative performance against the others in the study, or its so-called performance IQ, was Amgen Inc. Its chief executive, Gordon M. Binder, received a total direct compensation of $980,000.

It was followed by St. Jude Medical Inc., which paid Lawrence A. Lehmkuhl $1.08 million.

The worst performing company during the chief executive officer's tenure, again measured by performance IQ, was Tandy Corp. Its chief executive, John V. Roach, received $1.47 million. It was followed by Federal Express Corp., which paid Frederick W. Smith $660,000.

Measuring the compensation of an executive is difficult, and controversial, because there is no agreement on the elements of total compensation. (In cases where there are two or more co-chief executives, such as at Time Warner Inc. and Nordstrom Inc., the study aggregates their pay to arrive at one figure.) Compensation for a chief executive officer typically consists of a half-dozen elements:

- base salary;
- bonus for annual performance, whether paid currently or deferred;
- annualized present value of stock option grants;
- annualized value at grant of restricted stock awards;
- annualized value at payout of performance share and performance unit awards; and
- miscellaneous compensation, such as the value of interest-free loans and the value of perquisites.

The sum of all of these elements is defined in the study as the chief executive officer's total direct compensation — TDC.

But the more popular conception of pay to lay people is the sum of only two of the elements — base salary and bonus for annual performance. Termed the chief executive's total current compensation, or TCC, this limited conception of pay consists generally of the amount a chief executive officer receives in cash unequivocally in the preceding year; and it's the amount easily identified in proxy statements.

But cash isn't the only thing of value a chief executive receives in compensation. Looking at TCC alone fails to account for the other compensation an executive has, even though he may not receive it immediately in cash. Most shareholders miss the other elements of compensation. In terms of TCC, for example, Coca-Cola's Mr. Goizueta received $3.14 million, compared with his TDC of $63.6 million.

The more inclusive figure — the TDC — isn't a number found easily in proxy statements or the one corporations want shareholders to emphasize. The TDC includes rewards for past performance and incentives for future performance. But its value has a more theoretical base because stock grants or options are restricted or not practically exercisable, thus a chief executive officer can't immediately receive cash for all of these forms of compensation. Except where indicated, the study uses TDC as the chief executive officer's pay.

The study acknowledges other methods of calculating TDC. In this regard, most prominent is the compensation of H.J. Heinz Co.'s chief executive, Anthony J.F. O'Reilly, whose 1991 TDC was either $3.63 million or a whopping $75.08 million, which would put him ahead of Coca-Cola's Mr. Goizueta.

The difference lies solely in the way the stock option grants are calculated. The normal TDC calculates the present value of stock options grants the year they are granted and thus arrives at the $3.63 million, giving Mr. O'Reilly a relatively modest ranking in the study. But the alternative TDC calculates stock options based on the gains received in the year exercised; because Mr. O'Reilly chose to exercise last year grants received in previous years, some consultants would thus calculate his 1991 compensation at $75.08 million. This alternative TDC of using stock option gains has shortcomings. A significant one is that if Mr. O'Reilly waited until, say, after he retired to realize his gain, the big gain he receives after his tenure as CEO is finished would never have been recognized as part of his compensation, although the options clearly were part of his remuneration, and thus his total pay as CEO would have been underreported.

The study shows almost 90% of the variation in total direct compensation has nothing to do with two key factors — company size and company performance — that ought to explain all, or almost all, of the variation in chief executive officer pay.

With this much randomness in pay, the evidence is doubtful there is a market for chief executive officer talent. In other words, based on these factors, the study shows the market isn't allocating the resource of chief executive officers in an efficient fashion.

If money really motivated chief

See **Crystal** *on page 34*

LINDA SUE SCOTT

Graef Crystal found that measuring CEO pay is a difficult task because there is no consensus on elements of total compensation.

WHEN YOU HAVE QUESTIONS ON INSURANCE...
WE HAVE THE ANSWERS!

- Advisors Errors and Omissions
- Pension Consultants Liability
- Directors and Officers Liability
- Fidelity Bonds
- ERISA Bonds
- Mail Loss Insurance
- Discrimination and Disability Act Liability (new)
- Securities Brokers Liability
- State Surety Bonds
- Fiduciary Liability
- Transfer Agents Liability

Financial Institution Insurance is our business, and we've specialized in it for over 30 years.

We represent all major insurers and our knowledge and experience enables us to identify the insurance companies that can offer your firm the most competitive coverage. In most instances, we can improve your coverage and reduce premium costs.

You can only benefit from our analysis of your present insurance policies by calling us for a free insurance review, or information on any of our coverages.

Please contact Ted Liftman, president, at 617-439-9595, or fax 617-439-3099.

Theodore Liftman Insurance, Inc.
FINANCIAL INSURANCE

101 Federal Street
Boston, Massachusetts 02110-1800

Established in 1957

Nuts and bolts of CEO compensation study

The study of the 1991 pay of chief executive officers of 300 of the largest corporations focuses on three critical elements:

- the method of calculating the present value of stock option grants;
- a company's relative size — a potentially key determinant of CEO pay — known as its size IQ score; and
- a company's relative performance, known as its performance IQ score.

Valuing stock option grants

The study values stock option grants at their present value. The calculation begins by determining the size of the option, which is the product of the number of shares granted and the strike price of the option per share, that is, the price the executive must pay to exercise the option. The calculation then follows a number of steps, consisting of several other key elements:

- estimate the expected future total shareholder return, including stock appreciation and dividends, for each company, using the capital asset pricing model;
- assume the option, typically having a 10-year term, will be exercised eight years after its grant;
- calculate the expected future value of the option, based on the foregoing assumptions, less the strike price of the option;
- discount the future value of the option by a rate higher than the expected rate of return determined by the capital asset pricing model in recognition of the higher risk of an option compared to a stock;
- adjust the present value of the option if the ratio of a company's market price per share to its book value per share is abnormally high or low; and
- multiply the number of shares in the option grant by the option's adjusted present value per share to produce the total grant's present value.

For the 300 companies in the study, the present value of the options averages 31% of the options' aggregate strike price range. The range is from 10% to 65%.

Size IQ

The study determines the size IQ of a company by taking into account: company sales; invested capital (typically shareholders' equity plus long-term debt); and the total number of employees.

Like its counterpart in intelligence testing, the data are set so the average company has an IQ of 100 and the standard deviation of the distribution is 15. If the distribution were perfectly normal, 95% of the companies would fall within an IQ range of 70 and 130.

Of the 300 companies surveyed, General Motors Corp. has the largest size IQ at 148, followed by Ford Motor Co. at 146, IBM Corp. at 140, General Electric Co. at 139 and Sears Roebuck & Co. at 137.

St. Jude Medical Inc. has the smallest size IQ at 52, followed by ALZA Corp. at 57, Newmont Mining Corp. and Amgen Inc., both at 64, and Tambrands Inc. at 65.

Performance IQ

The study measures company performance — its so-called performance IQ — as the total shareholder return. The return is first measured over the 10 years ended Dec. 31, 1991, and then for successively shorter cumulative annual periods to capture long-, medium- and short-term performance. Thus, return is measured for the 10 years, then for nine years, then for eight years and so on to achieve 10 time windows. The returns are smoothed to compensate for normal market randomness and transformed into IQ scores, similarly to size IQ. That is, the average company return has an performance IQ of 100.

For CEOs who have held their jobs for 10 years or more, their pay also is compared against the performance IQ's 10-year time window. For CEOs who have held their job for less than 10 years, their pay is compared to the shareholder return time window that matches their tenure. Thus, if a CEO held his job six years, his pay is compared to the six-year total shareholder return time window.

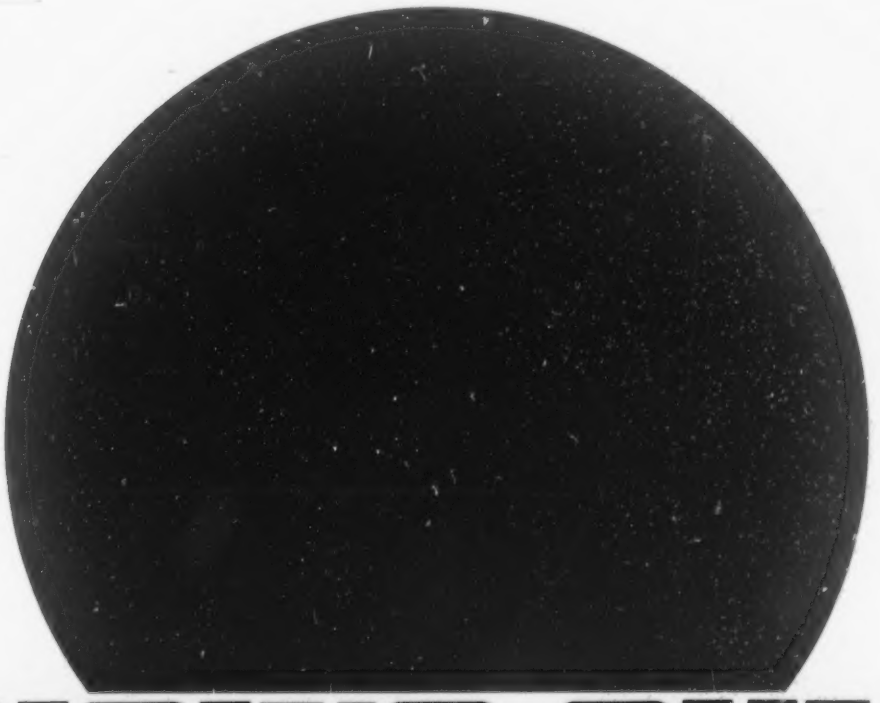
The final performance IQ score for a company is determined by placing 50% of the weight on the 10 performance periods and the other 50% to the performance IQ matching the CEO's tenure. For CEOs who held their jobs for fewer than three years, the study places comparably less weight on the performance IQ for the time window matching their tenure and more weight on the 10-year window performance IQ. This adjustment avoids placing too much weight on performance of such a short-term nature.

The study makes one other adjustment to the performance IQ to eliminate outliers. For companies with performance IQs above 150 or below 50, their scores were adjusted, respectively down to 150 or up to 50.

The Gap Inc., St. Jude Medical and Amgen have the largest performance IQs, all at 150, followed by U.S. Surgical Corp. at 147 and Costco Wholesale Corp. at 144.

Tandy Corp. has the lowest performance IQ at 63, followed by Digital Equipment Corp. and Federal Express Corp., both at 68, and Citicorp at 69.

— Graef Crystal



RISING SUM.

In their first two years, Nikkei 225 Stock Average futures and options on the Chicago Mercantile Exchange have set trading records many contracts don't reach in a lifetime. And now, with over 500,000 contracts traded, it's easy to see why.

After all, the broad-based Nikkei 225 is Japan's most widely followed stock average. And these extremely liquid, dollar-settled contracts offer risk managers faster, more efficient access to this incredibly important market. In one efficient transaction, you can add price protection or portfolio diversification without worrying about swings in dollar/yen rates.

No wonder the Nikkei 225 on the CME is more liquid than any other U.S. exchange-traded Japanese stock index. Number one in dollar value of average daily volume. Number one in dollar value of open interest–recently over $1.5 billion.

It's been an incredible two years. And to all the stock index traders, money managers, index & pension fund managers who've supported this contract from day one we say "Arigato." Thank you.

CHICAGO MERCANTILE EXCHANGE®
The Exchange of Ideas®

The Nikkei Stock Average is owned by and proprietary to Nihon Keizai Shimbun.

U.S. Toll Free 1-800-331-3332 London 071-920-0722 Tokyo 03-3595-2251

MFS group restructured

BOSTON — Massachusetts Financial Services has restructured and renamed its institutional investment management division.

The MFS Asset Management Group, formerly known as the investment counsel division, is being directed by a team of managing directors responsible for investment, sales and marketing and client services.

The group, which manages $3 billion for 34 clients, is functioning independently of its parent company.

John E. Jamieson, senior executive vice president of MFS, is heading the asset management group. ■

Crystal

Continued from page 31

executive officer performance, one might conclude the more long-term incentive plans in which the CEO participated the better. This conclusion, however reasonable, is wrong.

An analysis of incentive plans found that if the chief executive participates in no long-term incentive plans at all, he is likely to be paid 37% below the presumed market rate of compensation. If he participates in a single long-term incentive plan, he is likely to be paid 12% above the market. If he participates in two long-term incentive plans, he is likely to be paid 59% above the market; and if he participates in three long-term incentive plans, he is likely to be paid 108% above the market.

This analysis indicates companies don't play a zero-sum game when they add a new long-term incentive plan to their executive compensation arsenal. That is to say, they don't cut back on the size of grants under existing long-term incentive plans.

Of interest to shareholders, the relationship between long-term incentive plans and company performance is negative. Each additional long-term incentive plan in which a chief executive participates subtracts on average 1.3 percentage points from the company's 10-year total shareholder return.

On average, chief executives participating in three long-term incentive plans earn far more in compensation than the presumed market rate, while their companies achieved slightly below average performance.

The chief executives with the most sensitive pay packages — in terms of sensitivity to company performance — tend to bear the most risk as well as stand to gain the most reward. Typically, the chief executives who own huge amounts of the stock head both lists. Take two scenarios, one upside and one downside, when a typical company's stock is expected to produce a total return of 12% or a loss of 12%, although the exact figure varies from company to company, depending on each one's particular assumptions.

In the upside scenario, Berkshire Hathaway Inc.'s Warren Buffett has the most sensitive pay in terms of absolute dollars, standing to gain $3.451 billion. In the downside scenario, Mr. Buffett also bears the most risk, standing to see his pay fall $2.09 billion.

Interestingly, the results show a highly significant relationship between the riskiness of a company, as measured by either its stock price volatility, or beta, and the pay sensitivity downside scenario ratio. The ratio measures the dollar amount by which the value of the downside scenario pay package is less than the dollar amount of the base pay package.

Charles P. Lazarus, chief executive, Toys 'R' Us Inc., had the lowest ratio at 0.19, meaning in a downside scenario of the stock, his pay ultimately would be only 19% of its base value. Following just behind him are Apple Computer Inc.'s John Sculley at 0.27, Primerica Corp.'s Sanford I. Weill at 0.28, and U.S. Surgical Corp.'s Leon C. Hirsch and Becton Dickinson & Co.'s Raymond V. Gilmartin, both at 0.30.

Typically, the lower the downside scenario ratio, the higher the stock's beta. Thus, the chief executives who have the most to lose are also the most likely to take on more business risk. This finding may appear counterintuitive in the view that those with a lot to lose would be more risk averse. But for the most part, chief executives with the lowest ratios have the most to gain, in dollars, if the stock price increases rather than retreats.

There is also a highly significant relationship between the downside scenario ratio and past company total shareholder return. In this case, the lower the ratio, the higher the company's past shareholder return.

Thus, these results appear to confirm that money indeed motivates. But studying the ratio of the same pay package values under an upside scenario undermines the concept of money as a motivator. The study found no solid statistical relationship between the upside package and past company performance.

The reason for this dichotomy: Although high downside risk always is associated with high upside reward, low downside risk is not always associated with low upside reward. Berkshire Hathaway's Mr. Buffett or Microsoft Corp.'s William Gates, for example, can lose billions if their companies take it on the chin, but they also can make billions if their companies prosper. But not so with a CEO who owns few shares of his company's stock but has a lot of options on shares. In this case, the chief executive stands to lose little if his company performs poorly, while making millions if it performs well.

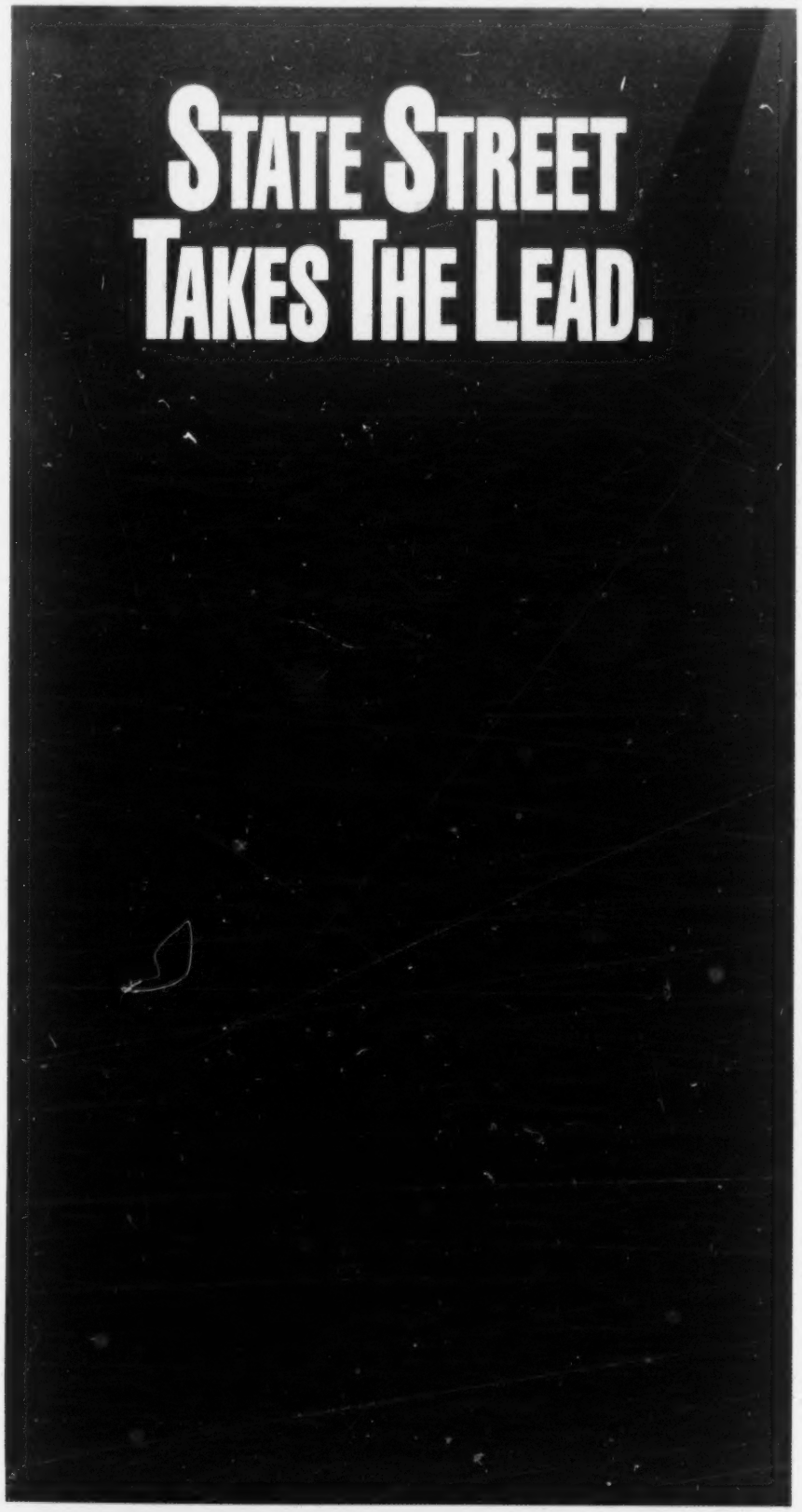
Company size shows little correlation between company performance and chief executive compensation. The largest company ranked by relative size, or size IQ, General Motors Corp., paid Robert C. Stempel a TDC of $1.64 million. Of the next largest companies, Ford Motor Co.'s Harold A. Poling received $1.63 million; IBM Corp.'s John F. Akers, $4.93 million; General Electric Co.'s John F. Welch, $7.89 million; and Sears Roebuck & Co.'s Edward A. Brennan, $2.23 million.

In turn, at the smallest company, St. Jude Medical, Mr. Lehmkuhl received $1.08 million. Of the next smallest, ALZA Corp.'s Martin S. Gerstel received $450,000; and Newmont Mining Corp.'s Gordon R. Parker, $1.85 million.

Other results of the study show Coca-Cola's Mr. Goizueta, not surprisingly, led the list of chief executives with the largest dollar increase in total direct compensation with a raise of $52.91 million. Following him were U.S. Surgical's Mr. Hirsch, whose increase of $27.76 million raised his compensation to $42.73 million; Quaker Oats Co.'s William D. Smithburg, with $8.74 million to $10.24 million; and W.R. Grace & Co.'s J. Peter Grace, with $7.75 million to $10.25 million.

Mr. Grace, besides receiving one of the largest compensation increases, was the most relatively highest paid chief executive officer in relation to his company having the lowest relative performance. Based on the study's analysis, he made $9 million more than he should have in 1991.

On the other hand, Time Warner's dual team of Steven J. Ross and N.J. Nicholas felt the largest dollar decrease in their total direct compensation last year. Their combined compensation fell $88.62 million to $11 million. Following them was Reebok International Ltd.'s Paul B. Fireman, whose compensation fell $30.78 million to $2.52 million; Walt Disney Co.'s Michael D. Eisner, falling $5.79 million to $5.44 million; and Sara Lee Corp.'s John J. Bryan, falling $4.35 million to $2.28 million. ■



Now you can have your cake and eat it too. You can give your employees all the participant services they demand without sacrificing any of your other objectives, including investment performance and cost control.

DEVELOPING 401(k) PLANS WITHOUT COMPROMISE.

At State Street, we have always understood the importance of satisfied employees. So we have designed our administrative systems to accommodate their needs for telephone access, daily valuations and easy transfers.

At the same time, we also understand your commitment to investment results. You want a plan with real options and solid performance: State Street can provide those.

As the largest trustee in the country and the third largest manager of pension funds, we have a successful track record in servicing a wide range of plan options, including a company's own stock.

Tell us what you need. Call Joseph G. Eck, Vice President, at (617) 985-2162.

State Street

© 1992 State Street Bank and Trust Company. 225 Franklin Street, Boston, MA 02110. Member FDIC.